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September 19, 2005

**AGENDA ITEM 8e**

**TO: MEMBERS OF THE INVESTMENT COMMITTEE**

**I. SUBJECT:** Spring-Fed Pools for International Equity Management and U.S. Equity Enhanced Indexing Management

**II. PROGRAM:** Global Equity

**III. RECOMMENDATION:** Subject to successful negotiation of fees and terms:

(1) Approve the following managers for inclusion in the spring-fed pool of managers for international equity enhanced indexing services:

AQR Capital Management  
Quantitative Management Associates

(2) Approve the following manager for inclusion in the spring-fed pool of managers for active international equity management services:

Acadian Asset Management

(3) Approve the following manager for inclusion in the spring-fed pool of managers for U.S. equity enhanced indexing services:

T. Rowe Price Associates

(4) Approve the use of annual review contracts for the managers to be included in the spring-fed pools in recommendations 1-3 above.

Wilshire Associate's opinion letter is shown in Attachment 1. Wilshire's conflict of interest disclosure is shown in Attachment 2.

#### **IV. ANALYSIS:**

##### **Background**

At its November 17, 2003 meeting, the Investment Committee approved the issuance of a Request for Proposal (RFP) with a Spring-Fed Pool feature for U.S. equity enhanced indexing managers. At its June 14, 2004 meeting, the Investment Committee approved a group of ten managers for inclusion in the spring-fed pool as a result of this RFP. Seven of these managers have been funded and one additional manager is expected to be funded soon.

At its October 18, 2004 meeting, the Investment Committee approved the issuance of a RFP with a Spring-Fed Pool feature for (1) international enhanced indexing managers and (2) international active managers. At its April 18, 2005 meeting, the Investment Committee approved a group of three enhanced indexing managers and a group of five active managers for inclusion in two spring-fed pools, as a result of this RFP. Staff is finishing up contract negotiations and expects to begin funding a number of these managers shortly.

Staff noted in the April 18, 2005 Investment Committee agenda item that there were a few managers who had just missed meeting the minimum qualifications as of the RFP deadline, but met the minimum qualifications soon after, and that those managers could be evaluated for inclusion in one of the pools after the pools were established.

On June 10, 2005, staff availed itself of the Spring-Fed Pool feature of both RFPs and re-issued these RFPs to add additional managers to the pools. Proposals were sent to five firms identified by staff and Wilshire Associates as good potential candidates for inclusion in the three existing pools of managers. These re-issued RFPs provide for optional Investment Committee interviews of the finalists.

##### **Manager Search Process**

CalPERS received two proposals for international equity enhanced indexing services, one proposal for active international equity management services, and two proposals for U.S. equity enhanced indexing services.

All of the proposals were read and scored by staff according to the criteria listed in the RFPs. The scoring categories included:

- Organization / Investment Professionals
- Investment Philosophy and Process
- Trading Process and Systems

- Performance
- Composite / Product Information

Four firms were invited to interview with staff at CalPERS offices on August 17, 2005. One firm's written proposal did not score high enough to continue in the process. Representatives from Wilshire Associates were in attendance at the interviews. The interviews were scored by staff in accordance with the criteria listed in the RFP. The scoring categories included:

- Business Strategy
- Organization / Investment Professionals
- Investment Philosophy and Process
- Trading Process and Systems
- Risk Management

Fee proposal scores were combined with the Technical Proposal and Staff Interview scores to determine the firms to be recommended to the Investment Committee. All four firms that were interviewed are being recommended to the Investment Committee.

### **Annual Review Contracts**

Staff recommends the use of annual review contracts, which provide for an undefined duration. This is consistent with the contracting procedure used for all other investment management contracts. This recommendation is necessary to fulfill CalPERS' fiduciary duties to its members because the use of annual review contracts is a more efficient use of CalPERS staff and Board time and other resources. The award of contracts without a defined duration is allowed under Board Resolution 92-04B-4.

### **Funding**

Funding to the recommended managers will come primarily from assets that are managed on a passive basis. In addition, some funding may be obtained from a reduction in the assets of CalPERS' current active equity managers and/or from cash inflows.

## **V. STRATEGIC PLAN:**

Goal IV: Assure that sufficient funds are available, first to pay benefits and, second, to minimize and stabilize employer contributions.

**VI. RESULTS/COSTS:**

Funding to the new managers will expand the Global Equity opportunity set and is expected to enhance risk-adjusted returns in this asset class.

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Senior Portfolio Manager

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Christianna Wood  
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Mark Anson  
Chief Investment Officer